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May 2, 2005

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE
WITH OMB CIRCULAR A-133**

The Honorable Christine Gregoire
Governor, State of Washington

Dear Governor Gregoire:

Compliance

We have audited the compliance of the state of Washington with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2004. The state's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the state's management. Our responsibility is to express an opinion on the state's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the state's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the state's compliance with those requirements.

We were unable to obtain sufficient documentation supporting the compliance of the state of Washington's Medicaid program regarding the allowability and eligibility of all costs, approximately \$6.1 billion, for the period July 1, 2003 to June 30, 2004 due to a client-imposed scope limitation. Further, we were not able to satisfy ourselves as to the state's compliance by other auditing procedures. This scope limitation is described in finding 04-01 in the accompanying schedule of findings and questioned costs.

Findings 04-02 through 04-09 describe the results of limited testing that demonstrate the attempts made to perform the Medicaid review for compliance with allowability of services, eligibility of individuals and eligibility of providers. Findings 04-10 through 04-22 describe the state of Washington's non-compliance with requirements of other areas of the Medicaid program that are included in the overall program disclaimer.

In our opinion, except for the effects of the noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding the Medicaid program as described in the preceding paragraphs, the state complied, in all material respects, with the requirements referred to above that are applicable to each of its other major federal programs for the year ended June 30, 2004. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as findings 04-23 through 04-49.

In addition, we noted certain matters involving immaterial noncompliance that we have reported to the management of the state of Washington in separate letters issued at the state agency level.

Internal Control Over Compliance

The management of the state is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the state's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

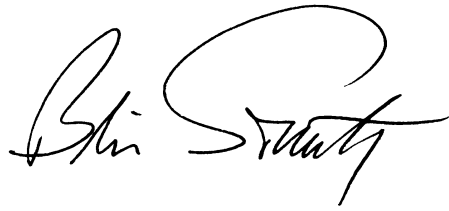
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the state's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as findings 04-10, 04-15, 04-19, 04-20, 04-22, 04-25, 04-33, 04-34, 04-45 and 04-47.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We consider all the findings listed in the prior paragraph to be material weaknesses.

Schedule of Expenditures of Federal Awards (note 1)

We have audited the basic financial statements of the state of Washington as of and for the year ended June 30, 2004, and have issued our report thereon dated December 16, 2004. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended for the information of state management and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

A handwritten signature in black ink, appearing to read "Brian Sonntag", with a large, stylized loop at the end.

BRIAN SONNTAG, CGFM
STATE AUDITOR

Note 1: The date of our report on compliance and internal control is May 2, 2005. The date of our opinion on the schedule of expenditures of federal awards is April 22, 2005.

